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Letter dated 6 July 2004 from the Secretary-General addressed to the President of the Security Council

Pursuant to Security Council resolution 1483 (2003), I have the honour to convey the attached letter from my representative on the International Advisory and Monitoring Board for Iraq.

It will be noted that the report does not contain any financial data, pending the completion of the audit of the Development Fund for Iraq, which the Board intends to make public.

I should be grateful if this letter could be brought to the attention of the members of the Security Council.

(*Signed*) Kofi A. **Annan**

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Annex

Letter dated 30 June 2004 from the representative of the Secretary-General on the International Advisory and Monitoring Board addressed to the Secretary-General

As your representative on the International Advisory and Monitoring Board for Iraq, I am pleased to report to you on the Board's activities since its inception.

The International Advisory and Monitoring Board first met in an organizational session on 5 December 2003 in New York, and has met on a monthly basis since. It was agreed at the organizational session that I, as your representative, would chair the Board for a term not to exceed one year.

Audit of the Development Fund for Iraq

The Board's first priority was to complete expeditiously the statement of work for the external auditors to be appointed by the Administrator of the Coalition Provisional Authority, subject to the approval of the Board, to undertake an audit of the Development Fund for Iraq and to audit the oil export sales to ensure that these are made consistent with prevailing best practices. The Board completed its review of the statement of work by the end of 2003 and submitted it to the Administrator of the Authority. After consultations with the Board, the Coalition Provisional Authority proceeded to seek solicitations for the award of a contract for the audit. Following the evaluation process by the Authority of the solicitations received from external audit firms, and following further examination of the qualifications of the audit firms, the Board on 24 March 2004 approved the appointment of KPMG. The Board was satisfied with the international composition of the audit team, including the commitment by KPMG to include internationally experienced and specialized audit partners, and the use of international standards on auditing.

The scope of the audit by KPMG covers:

(a) The export sales of oil, petroleum products and natural gas from Iraq, supporting the objective of ensuring that the export sales are made consistent with prevailing international market best practices;

(b) The Oil Proceeds Receipts Account held by the Central Bank of Iraq at the Federal Reserve Bank of New York;

(c) The Development Fund for Iraq (including, but not limited to, all inflows, investments and other assets, disbursements, liabilities and contingencies of the Fund), to ensure that the Fund is used in a transparent manner in accordance with applicable control procedures;

(d) Disbursements of resources from the Development Fund for Iraq to ensure that they are in accordance with the provisions of paragraph 14 of Security Council resolution 1483 (2003) and that Fund resources are used in a transparent manner and for the purposes for which they were disbursed.

For the purposes of (a) and (b) above, the audit will verify that all sales and related receipts are accurately accounted for and that the distribution of receipts between the Development Fund for Iraq and the United Nations Compensation Fund account are accurately reflected, and for the purposes of (c) above, the Fund

financial statements prepared by the Coalition Provisional Authority will be audited. For the purposes of (d) above, the audit will determine whether disbursements from the Fund are duly authorized and received by the designated recipient and will assess whether the controls of the designated recipient are adequate to ensure that disbursements from the Fund are utilized as intended.

At its subsequent meetings in April, May and June 2004, the Board received briefings by KPMG regarding the progress made in the audit. The report for the audit covering the period from inception to 31 December 2003 will be submitted to the Board in time for its meeting scheduled for 14 and 15 July 2004. The report for the audit covering the period from 1 January to 30 June 2004 is expected to be submitted in September 2004. The Board intends to make public the audits and will also provide comments thereon.

Areas of concern

In carrying out its responsibilities, the Board also sought and obtained from the Coalition Provisional Authority a series of detailed briefings in a number of areas of interest to the Board relating to the financial functions and operations of the Development Fund for Iraq, the oil extraction and sales and the internal controls in place. The Authority cooperated fully with the Board in this respect. As a result of those briefings the Board identified a number of issues of concern which it conveyed to the Authority and the public.

(a) Controls over the extraction of oil

The Board noted that there was a lack of adequate control over the extraction of crude oil, as evidenced by the absence of metering or measurement of extracted oil quantities. The absence of metering for crude oil extraction and sales precludes a reconciliation of all crude oil extracted with its eventual utilization, and allows oil proceeds to be diverted.

While the Board understood that this situation may have preceded the arrival of the Coalition Provisional Authority, the Board believed that this was a critical weakness that needed to be remedied so as to ensure that oil export sales have been deposited in the Development Fund for Iraq and can be used for the intended purposes.

The Board recommended the expeditious installation of the metering equipment. It was subsequently informed by the Coalition Provisional Authority that steps were being taken to address this issue first by adopting measures to curtail reported smuggling activities and by the allocation of resources to implement a metering system.

(b) Bartering

The Board noted that, initially, a share of the residual oil from the refining process was transacted through barter sales in exchange for light oil products and other commodities such as electricity. The Board was informed that the Coalition Provisional Authority intended to gradually eliminate these barter transactions. The Board recommended that this should be completed expeditiously considering that revenues from such sales not currently deposited in the Development Fund for Iraq and because of the scope for fraudulent or non-transparent transactions. At its last

meeting, in June 2004, the Board was informed that there was only one bartering contract remaining, and that the estimated bartering sales had been valued at $225 million, which would result in a potential compensation of $12 million to the United Nations Compensation Fund.

(c) Sole-sourced contracts

The Board was informed that the Coalition Provisional Authority had awarded contracts funded from the Development Fund for Iraq resources without using competitive bidding procedures. The Board conveyed to the Authority a request that any audit relating to sole-sourced contracts awarded using Fund resources is communicated to the Board. The Board was at the time considering requesting a special audit in accordance with its terms of reference but wanted to review the findings of any existing audit report by the Authority to avoid duplication of work.

So far, the Board has not been able to obtain access to these audits and therefore decided to call for a special audit as envisaged under its terms of reference. The scope of the audit would be to identify all sole-sourced contracts funded from the Development Fund for Iraq, document each contract's terms, the justification for sole-sourcing, and the procedures to ensure fair delivery of the contract, summarize the results of audits already performed, prepare a summary report of key findings, assess whether each contract was executed in accordance with the contractual provisions, whether disbursements were made consistent with the provisions of paragraph 14 of resolution 1483 (2003) and whether the funds were used in a transparent manner and for the purposes for which they were disbursed.

The Board was informed at its meeting in June 2004 that the Coalition Provisional Authority was proceeding with making arrangements to put the request for such an audit out for bidding.

Observers

The Board appointed two observers from the Iraqi Governing Council and one from the Coalition Provisional Authority. The participation of observers in the meetings of the Board as well as that of invitees from the Iraqi Board of Supreme Audit and the Authority provided the Board with useful opportunities to exchange views and gain a better understanding of the operations in Iraq.

Dissemination of information

The Board established a web site (www.iamb.info) to ensure the widest availability to all interested parties of documentation and information related to its operations. All documentation, including the minutes of its meetings, press releases and terms of reference, is posted on the site. The site provides the user with a facility to contact the Board to seek additional information and/or clarifications. It also has a link to the web site of the Coalition Provisional Authority where information on the Development Fund for Iraq can be accessed. This site is accessed frequently and the Board has been responding to enquiries as they have arisen.

The future

The Board has requested the Administrator of the Coalition Provisional Authority to designate an official to act as counterpart to the Board after 30 June in connection with the finalization of the ongoing audits and to ensure that arrangements are made to preserve all records in order to enable the auditors to successfully conclude their work. The Board is contacting the Government of Iraq regarding the designation of a duly qualified individual as an additional full voting member of the Board as decided by the Security Council in paragraph 24 of its resolution 1546 (2004). The Board is also in the process of revising its terms of reference in the light of changes brought about by resolution 1546 (2004).

(*Signed*) Jean-Pierre **Halbwachs**
Representative of the Secretary-General on the
International Advisory and Monitoring Board